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Antitrust—Vertical Division of Markets.—White Motor Co. v. United States; Snap-On Tools v. Federal Trade Commission

Paul E. D'Hedouville

patent monopoly that any exchange of patent rights between two or more parties may be deemed to be a violation of the antitrust laws. Such a restrictive view of patent rights, while coming close to abolishing the patent monopoly, will clearly lead to a curtailment of patent exchanging in industry, when the apparent effect of the exchange is to benefit both parties to the agreement. This curtailment of exchangeability may in turn lead to a lessening of competition if the parties, reluctant to face antitrust suits, refuse to license other parties to use their developments. Further, this natural progression of conclusions from recent cases, emphasizing concerted activity, appears to be in direct conflict with the statutory free assignability of patent rights and the prior precedent requiring clear evidence of a monopoly, price fixing scheme or other type of patent abuse before patent transfers would be deemed conspiracies in restraint of trade.

ROBERT T. TOBIN

Antitrust—Vertical Division of Markets.—*White Motor Co. v. United States;*[1] *Snap-On Tools Corp. v. Federal Trade Commission.*[2]—Restrictions on the ability to compete are at the heart of antitrust violations.[3] These restrictions continue to vary in form, as different in technique as there are differences in the whole mercantile sphere. Even so, while the form may generally govern a court's approach to a possible restraint, it is rather the effect of the restrictive market distribution agreements which should dictate the response.[4] This duality in antitrust litigation becomes especially evident when the court is presented with a *sui generis* of form; as in the cases here noted, the two courts confront initially the vertical territory limitation.[5] In the one instance—*White Motor*—a wholesale manufacturer of trucks, and the other—*Snap-On Tools*—a wholesale producer of tool equipment, each decided that the sound method of marketing its product was the use of independent distributorships. The independence, however, was less than total since the truck and the tool retailers each signed a contract limiting their access to markets by prescribing delineated geographic areas in which a distributor or retailer could do business. Additionally, there could be no competition with the manufacturer in acquiring certain large accounts, e.g., government contracts.

The essential quality of the form of the respective practices was that the origin of the restraints on market areas came from the manufacturer down to the distributor. In the instance of White Motor Co., there were also signed

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1 372 U.S. 253 (1963).

2 321 F.2d 825 (7th Cir. 1963).

3 [A]greements or combinations between dealers, having for their sole purpose the destruction of competition . . . are injurious to the public interest and void.

Dr. Miles Medical Co. v. John D. Park & Son Co., 220 U.S. 373, 408 (1911).

4 The test of illegality under the Sherman Act is the presence of an unreasonable restraint without regard to whether the conspiracy is among affiliated parties or those integrated under common ownership or among those otherwise independent. United States v. Yellow Cab Co., 332 U.S. 218, 227 (1947).

5 The note will treat primarily the geographic restrictions imposed by the manufacturer; the restrictions on the classes of customers to be served raise substantially the same issues.

reciprocal contracts among the distributors.[6] The dealers of Snap-On Tools, however, were not *in form* contracting with other dealers.[7] Further, the limiting effect upon competition was entirely upon the sales of the one brand.[8] Thus, these traits of the form dictated the designation: vertical territory limitations.

The respective government agency in each case attempted to penetrate form by contending that the restriction was among potential competitors on the same level of distribution, despite the origin of the restraint. Hence, while the arrangement may be limited to the one brand, it is, nevertheless, a division of markets between competitors.[9]

When a court does get beyond the form to the content of the restraint, there is essentially one test applied to judge effect—actual or potential unreasonable restraint of competition.[10] This is manifested by practices that "restrict production, raise prices, or otherwise control the market to the detriment of purchasers or consumers. . . ."[11]

There are two approaches for determining if such effects do exist: (1) the totality of surrounding circumstances, including intent, which may indicate the unreasonable nature of the restraint; or (2) the use of precedent to indicate without need of investigation, the illegality of the practice.[12] The former contemplates the use of the Rule of Reason and the complainant must prove a factual case subject to appropriate defenses.[13] This was the approach of the FTC in *Snap-On Tools Corp.*[14] The latter prevents the court from investigating the reasonableness of the individual restraint, and makes the agreement *a priori* void.[15] It was in this latter, per se, classification that the Justice Department attempted to place *White Motor Co.*[16]

There is already a full catalogue of forms ruled illegal per se and the Supreme Court was not lacking in varieties with which to compare this new variation.[17] Among the most notorious forms of restricting competition is the

[6] Mr. Justice Brennan is concerned in his concurring opinion as to who "induced" the agreements, concluding that if the dealers did so, primarily, the fact that the manufacturer imposed them would not save the agreements. Supra note 1, at 267.

[7] Mr. Justice Clark's dissent holds that the vertical origin is in reality more destructive than were the agreements among distributors because of the enforcement by the manufacturer. Supra note 1, at 279-80.

[8] White Motor Co. argues that this enables a more effective inter-brand competition. Supra note 1, at 256.

[9] The Court in *White Motor* side-steps the restrictions among dealers by considering the justification for the manufacturer to use these policies even though the restraint is among the distributors and perhaps it is here that the justification, if any, should be found.

[10] United States v. Griffith, 334 U.S. 100 (1948).

[11] Apex Hosiery Co. v. Leader, 310 U.S. 469, 493 (1940).

[12] Kor's Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959).

[13] Standard Oil Co. v. United States, 221 U.S. 1 (1911).

[14] The action was brought under the Federal Trade Commission Act, 38 Stat. 719 (1914), 15 U.S.C. § 45 (1958).

[15] Supra note 12.

[16] Justice Department complained under the Sherman Act, 26 Stat. 209 (1890), 15 U.S.C. §§ 1, 3 (1958).

[17] The Supreme Court has considered the following practices to be per se violations:

vertical price-fixing agreement between manufacturer and retailer. In *United States v. Parke, Davis Co.*,[18] the Court declared illegal per se an attempt by the manufacturer to eliminate competition among retailers by having its dealers coordinate efforts in keeping a floor under pricing. The Court found the crucial element to be the active coordination of manufacturer and retailer in fulfillment of the restrictive policy. The *Parke, Davis* case thereby presents two similarities to the instant case. The source, or vertical origin, was described in language appropriate to *White Motor Co.*: "The manufacturer is thus the organizer of a price-maintenance combination . . . in violation of the Sherman Act."[19] Further, one may inquire whether competition is not more severely limited by keeping a potential rival completely out of a market area as it is by eliminating one method of competition, i.e., pricing.[20]

The answer to this is supplied in case law holding territorial divisions of market among horizontal competitors to be a per se violation of the Sherman Act.[21] The crucial factor in these decisions is the origin of the agreement among horizontal competitors; such is the form difference from the instant cases.[22] Where competing firms agree not to compete and instead divide the market among themselves, this agreement is now considered to have a "pernicious . . . unredeeming" effect upon competition.[23] The Justice Department urged an analogy between the *White Motor Co.* case and *Timken Roller Bearing Co. v. United States*.[24] In the latter, the Court declared void per se an arrangement dividing the world into exclusive territories for each of the three parties. The potential competition was, in fact, over identical products and, further, the horizontal competitors were part of the same corporate structure.[25]

The vertical origin of territorial restrictions is, in its pure form, not strange in the law.[26] The approval given to certain varieties of restrictive marketing arrangements of a manufacturer can only be rationalized by the

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tying agreements, divisions of markets, group boycotts, and vertical and horizontal price fixing. Supra note 1, at 258-60.

[18] 362 U.S. 29 (1960).

[19] Mr. Justice Brennan distinguishes the instant case from this by considering vertical territorial divisions to have only intra brand effects, while vertical price restrictions have both intra- and inter-brand restraints. Supra note 1, at 268.

[20] (Where potential competitors agree not to compete in specified territories) . . . the consequence is to reduce the number of sellers in each affected market. Competition among contracting parties is eliminated even more completely than had they agreed on prices but still did business in the relevant market.

The Att'y Gen.'s Nat. Committee to Study the Anti-Trust Laws (1955) at 26.

[21] United States v. Addyston Pipe and Steel Co., 85 Fed. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899).

[22] The concern for the vertical vis-à-vis horizontal nature of the arrangement should not itself be determinative unless there can be shown a distinct effect from the particular form. See supra note 4.

[23] United States v. Bayer Co., 135 F. Supp. 65 (S.D.N.Y. 1955).

[24] 341 U.S. 593 (1951).

[25] The Court specifically considered this point:

The fact that there is common ownership or control of the contracting corporations does not liberate them from the impact of the antitrust laws.

Id. at 598.

[26] Mr. Justice Brennan discusses alternate legitimate methods for achieving vertical limitations on markets. Supra note 1, at 271, nn. 11, 12.

general distaste for finding a conspiracy within a corporate structure.[27] This arises from the *sine qua non* status of conspiracy in a Sherman Act violation and that one cannot conspire with one's self. In *Timken Roller Bearing*, the Court was only incidentally concerned with the corporate structure and looked beyond to the reality of potential competition. The closer the fact situation approaches a unitary commercial structure, the less inclined is a court to find a per se violation, preferring in such instances to hear the "economic and business stuff" involved.[28]

The issue facing the *White Motor* Court became simply whether here and now the practice of vertically originated agreements eliminated competition among dealers and should be banned without a hearing on the peculiar effects of the arrangement. The Court had a choice between reaching the conclusion that the contracts, on their faces, had the obvious pernicious effect upon competition such as to make them illegal per se, or that in each and every instance a hearing should be held under the "Rule of Reason" approach.[29] The Supreme Court decided neither, but only concluded that "[w]e need to know more than we do about the actual impact of these arrangements on competition to decide whether they . . . should be classified as *per se* violations."[30] In remanding the case for trial, the Court is concerned with hearing facts, not as to the business justification, but rather as to the effects on competition, both good and bad.[31] It is claimed by the manufacturer that the chief benefit of the agreement is that it enables the motor truck distributor to compete more effectively. The strenuous dissent presented by Justice Clark argues that such a benefit can be realistically characterized as making "virtue of business necessity."[32] If at the trial the business necessity motivation outweighs the beneficial effect on competition, then precedent would dictate the necessary result.[33]

The FTC engaged in just this type of hearing prior to the appeal to the Seventh Circuit, when it examined the "economic stuff" of the vertical ter-

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[27] It seems inconceivable to hold per se illegal the selection by the parent of those persons with whom its subsidiary may or may not deal.

The Att'y Gen.'s Nat. Committee to Study the Anti-Trust Laws, supra note 18, at 35.

[28] The Attorney General's Report would apply the "Rule of Reason" to the facts of the instant cases. "Exclusive distributorships may be established by a manufacturer as part of his marketing plan." Id. at 27.

[29] In a dissent to the Attorney General's Report, Louis B. Schwartz favoring the per se approach has the following criticisms of the "Rule of Reason":

1. It makes the proceedings intolerably long and expensive;
2. It operates . . . in favor of powerful defendants as against smaller units, since only the powerful can afford that kind of defense.

Id. at 392.

[30] Supra note 1, at 253.

[31] The policy of the antitrust laws does not depend for its enforcement on the shown convenience to the parties of a practice against which enforcement is sought.

United States v. Paramount Pictures, 334 U.S. 131 (1948).

[32] Supra note 1, at 278.

[33] Once, however, the Court does decide the practice to be per se illegal it would not matter whether an individual defendant could make a showing that (a) there is business advantage to the proponent; (b) there is a reduction in prices to the consumer; or even (c) increased competition. United States v. Masonite Corp., 316 U.S. 265 (1942).

ritorial restriction and customer limitations.[34] Since Snap-On Tools was engaged in other practices found to be contrary to the Federal Trade Commission Act, there was a legitimate dispute over whether there should have been—and was—a separate hearing on territorial restrictions. The court decided that since there was no separate hearing on the merits of territorial divisions, the court itself could make a finding on the legality of the practice.[35] Using the findings of the FTC examiner, the court approved of the agreements, quoting at length the manufacturer's motivation in the matter.

Despite the surface similarities in conclusions, there is a sharp contrast between the results reached in these cases. *White Motor Co.* was remanded for a trial on the facts as to the effect on competition, both good and bad, from the agreement, and to determine the relation of restraint to business need (Rule of Reason). The *Snap-On Tools Corp.* court, however, slides over the effect on competition, whether absolutely or relative to the business need. Rather, it is greatly impressed by the advantages to the manufacturer from the contracts—a defense that will never put a strain on the corporate party to an antitrust action.[36] Further, the *White Motor Co.* Court studiously avoids making a finding as to whether these vertical restraints are per se illegal, but only concludes that it cannot now decide.[37] The *Snap-On Tools Corp.* court, however, uses the decision for precisely what it does not hold—that vertical restrictions are entirely divorced in the Sherman Act from horizontal restraints.[38] Finally, the Seventh Circuit, even if justified in its conclusion that no separate hearing was given with respect to the territorial restrictions, should have followed the procedure of the Supreme Court and remanded the action for further hearing rather than reverse the conclusions of the Commission based not on law, but on facts. It is difficult to conclude as a matter of law that the evidence is so overwhelming in the case that the Commission made an incorrect finding of fact.

The matter of vertical agreements not to compete, while bearing strong resemblance to the past practices, probably was handled by the Supreme Court in a manner not surprising to the Justice Department.[39] However, the value of the decision, if read narrowly, seems transient and, while the case will not be reversed, it is likely to be superseded by a finding on the facts that

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[34] The Commission judged the contracts to be "a series of agreements having the effect of eliminating competition among all dealers concerned." Snap-On Tools Corp., 3 Trade Reg. Rep. at ¶ 20,413 (FTC dkt. 7116).

[35] While the court is correct on the fact that the territorial and customer limitations were considered in toto, the Commission's opinion also yields discussion as to the agreements having the "same destructive effects" as illegal horizontal agreements. Certainly the Commission must have examined the effects before making such a conclusion. Ibid.

[36] The Commission considered the business justifications, but decided it to be ". . . clear that the public is entitled to the benefit of competition on the dealer level." Ibid.

[37] "We do not intimate any view on the merits. We only hold that the legality of the territorial and customer limitations should be determined only after a trial." Supra note 1, at 264.

[38] "[T]he Supreme Court refused to equate a *vertical* arrangement by a manufacturer . . . to a horizontal arrangement among competitors. . . ." Supra note 2, at 831.

[39] "[S]ummary procedures should be used sparingly in complex antitrust litigation. . . ." Poller v. Columbia Broadcasting Sys., 368 U.S. 464, at 473 (1962).

these agreements are, henceforth per se illegal.[40] The *Snap-On Tools Corp.* decision will, in such an eventuality, be meaningless as precedent and, in effect, overruled.

PAUL E. D'HEDOUVILLE

Corporations—Protection of Incumbent Management by the Corporate Purchase of Its Own Stock—Business Judgment Rule.—*Bennett v. Propp.*[1]—Plaintiff-appellee brought a minority shareholders' derivative suit for an accounting, by the chairman and the board of directors of Noma Lites, Inc., and also for any damages proximately resulting from the allegedly improper expenditure of corporate funds in the purchase of the company's own capital stock. The chairman, without authority, had negotiated purchases of nearly two hundred thousand shares of Noma common stock in response to a letter, marked "personal and confidential," from Royal Little, the executive head of Textron, Inc. Therein was requested a list of Noma shareholders; it was further indicated that Little desired to obtain a controlling interest in Noma. Textron had previously been unsuccessful in its bid to garner a control interest in American Screw Company, a corporation in which Noma held 51 per cent of the outstanding stock, and it appeared that Little might now attempt to succeed by gaining control of Noma itself. Learning of the stock purchases only one business day before payment was due, Noma's board ratified the purchases although the financial instability of the corporation forced them to effect a loan, at one per cent interest per month, to meet the two million dollar purchase price. The Vice-Chancellor found the purchases to have been essentially motivated by the chairman's desire to further personal interests and preserve favored position; he refused to apply the business judgment rule to the board's resolution in view of the "precipitate and impulsive manner" in which they reached their decision.[2] On appeal to the Supreme Court of Delaware, it was HELD: the board was confronted with a *fait accompli*, which, if left unratified, might well result in serious financial embarrassment to the corporation. The urgency of the situation and the nature of the emergency justified the apparent haste with which the board meeting was conducted as well as the failure to consider possible alternate avenues of action. The court affirmed the finding of personal liability as to the chairman.[3]

The instant case is significant for the insight it may offer into the steps

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[40] Justice Clark characterized the decision thusly:

> Today the Court does a futile act in remanding this case for trial. In my view appellant cannot plead nor prove an issue upon which a successful defense . . . can be predicated. Certainly the decision has no precedential value in substantive anti-trust law.

Supra note 1, at 282-83.

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[1] — Del. —, 187 A.2d 405 (1962).

[2] Propp v. Sadacca, — Del. —, 175 A.2d 33 (Del. Ch. 1961).

[3] The court renumerated the accepted Delaware position that the board's resolution could not legalize the unlawful purchases of the chairman so as to exonerate him from liability. It only served to "take up the stock to save the corporation from financial difficulty." Supra note 1, at 411.